

**EXPLANATORY MEMORANDUM TO THE
TAX CREDITS (MISCELLANEOUS AMENDMENTS) REGULATIONS 2006**

S.I. 2006 No. 766

1. This explanatory memorandum has been prepared by HM Revenue & Customs (HMRC) and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. **Description**

This statutory instrument amends various tax credits regulations.

Firstly, the regulations amend regulations 11 (3) (a) and 33 (a) of the Tax Credits (Claims & Notifications) Regulations 2002 (S.I. 2002 No. 2014) as amended by regulation 3 (2) and (5) of the Tax Credits (Miscellaneous Amendments) Regulations 2004 (S.I. 2004 No. 762). This is to bring forward the deadline for the return of annual tax credits renewal notices from 30 September to 31 August, as announced in the Pre-Budget Report of 5 December 2005.

Secondly, the regulations correct a minor omission in regulation 5 (2) of the Child Tax Credit Regulations 2002 (S.I. 2002 No. 2007) as amended by regulation 4 of the Child Tax Credit (Amendment) Regulations 2003 (S.I. 2003 No. 738) and regulation 4 (3) of the Child Tax Credit (Amendment) Regulations 2006 (S.I. 2006 No. 222).

Thirdly, these regulations make amendments to the Tax Credits (Residence) Regulations 2003 (S.I. 2003 No. 654) and the Tax Credits (Residence) (Amendment) Regulations 2004 (S.I. 2004 No. 1243). The amendments update regulation 3 (4) of the Tax Credits (Residence) Regulations 2003 to take account of the fact that Council Directive 2004/38/EC has amended Council Regulation (EEC) No. 1612/68 and has repealed Council Directives No. 68/360/EEC and No. 73/148/EEC. They also amend regulation 1 (2) of the Tax Credits (Residence) (Amendment) Regulations 2004 to remove the date limit on regulation 3 (5) of the Tax Credits (Residence) Regulations 2003, thus making the right to reside condition contained in that earlier amendment permanent.

Fourthly, the regulations amend the Tax Credits (Definition & Calculation of Income) Regulations 2002 (S.I. 2002 No. 2006). They make consequential changes to the definition of "income" for the purpose of claiming the child and working tax credits, primarily arising from the entry into force of the Income Tax (Trading & Other Income) Act 2005, the Finance Act 2004 and the Finance (No. 2) Act 2005.

Finally, the regulations also update references to Employment Zones in both the Tax Credits (Definition & Calculation of Income) Regulations and the Working Tax Credit (Entitlement & Maximum Rate) Regulations 2002 and amend the child care provisions in the latter in respect of Northern Ireland and Scotland.

3. **Matters of special interest to the Joint Committee on Statutory Instruments**

None.

4. **Legislative Background**

Section 17 of the Tax Credits Act 2002 requires claimants to finalise their award for the previous tax year by stating or confirming any changes of circumstances and their income for the tax year in question. The deadline for the return of such information, which is also treated as a claim for the new tax year, is contained in a formal notice issued to the claimant under section 17. This deadline is currently 30 September, as provided in regulations 11 (3) (a) and 33 (a) of the Tax Credits (Claims & Notifications) Regulations 2002 as amended by regulation 3 (2) and (5) of the Tax Credits (Miscellaneous Amendments) Regulations 2004.

The Child Tax Credit Regulations 2002 will be amended by the Child Tax Credit (Amendment) Regulations 2006 to extend the prescribed conditions for a “qualifying young person” to include such persons who are on a specified training programme. The amendments will also provide that a qualifying young person continues to be such a person until he or she either completes his or her course of full-time, non-advanced education or training course or he or she reaches the age of 20, whichever occurs first.

Section 3 (3) of the Tax Credits Act 2002 provides that to claim the child and working tax credits, a person must be “in the United Kingdom”. Section 3 (7) contains a regulation-making power to allow the Treasury to prescribe when a person is treated as being or not being in the UK. These regulations are contained in the Tax Credits (Residence) Regulations 2003. Taken together, the legislation requires that to be treated as being in the UK for tax credit purposes, a person must be both present and ordinarily resident.

In certain cases, the tax credits residence provisions are subject to the requirements of EC law.

Subject to any relevant derogations, article 1 of Council Regulation (EEC) No. 1612/68 gives nationals of the European Economic Area (EEA) the right to take up activity as an employed or self-employed person, irrespective of their place of residence, and to pursue such activity in another Member State. Article 7 (2) of the Regulation further provides that a worker from an EEA Member State “shall enjoy the same social and tax advantages as national workers”. The working tax credit is a “social advantage” within article 7 (2) of the Regulation. As such, it is available to nationals of other EEA Member States who are exercising their rights to free movement as workers in the UK under that Regulation or Commission Regulation (EEC) No. 1251/70, which grants rights of residence to retired workers who last worked in the host country. It is also available to persons who have a right to reside in the UK under Council Directives No. 68/360/EEC (dealing with such rights for workers and their families) and No. 73/148/EEC (governing such rights for, among others, the self-employed and their families). These rights under EC law are explicitly recognised in regulation 3 (4) of the Tax Credits (Residence) Regulations 2003 which treats persons within the scope of these EC provisions as ordinarily resident in the UK for the purpose of claiming the working tax credit.

Council Directive 2004/38/EC entered into force on 30 April 2004. Member States are obliged to amend their national legislation to comply with the Directive by 30 April 2006. The Directive gives EU nationals an initial right of residence in another Member State for up to three months (provided they do not become an unreasonable burden on the social assistance system of the host Member State).

The Directive also gives EU nationals an extended right of residence of more than three months if they are workers or self-employed persons in the host Member State or otherwise are self-sufficient. Finally, the Directive gives EU nationals a right of permanent residence in another Member State if they have resided in that host country continuously for five years.

The Directive amends Council Regulation (EEC) No. 1612/68 and repeals, among others, Council Directives No. 68/360/EEC and 73/148/EEC. Consequently, regulation 3 (4) of the Tax Credits (Residence) Regulations 2003 must be updated:

- to refer to Council Regulation (EEC) No. 1612/68 as amended by Council Directive 2004/38/EC; and
- to delete the references to Council Directives No. 68/360/EEC and 73/148/EEC and replace them with a reference to Council Directive 2004/38/EC.

The Tax Credits (Residence) Regulations 2003 were amended when eight central European countries – Estonia, Latvia, Lithuania, Poland, the Czech Republic, Slovakia, Hungary and Slovenia – together with Cyprus and Malta acceded to the EU and EEA on 1 May 2004. The Tax Credits (Residence) (Amendment) Regulations 2004 provided that for new claims made on or after 1 May 2004, and up to 30 April 2006, access to the child tax credit is restricted to those people with a “right to reside” in the UK. This is in addition to the presence and ordinary residence conditions. Generally, nationals of the central European Member States only have a right to reside if they take up employment with an employer who is authorised to employ them under the Home Office’s Worker Registration Scheme or are exempt from such registration. Nationals of those Member States who are looking for work or are economically inactive (as well as other EEA nationals who are economically inactive) must have sufficient resources not to be an unreasonable burden on the social assistance system of the UK.

The amendments to the Tax Credits (Definition & Calculation of Income) Regulations 2002 and the Working Tax Credit (Entitlement & Maximum Rate) Regulations 2002 result from changes to other legislation that have an impact on those regulations. In the former, they arise in particular from the rewriting of the income tax charges on various types of income (for example, from property and self-employment) under Schedules A and D of the Income & Corporation Taxes Act 1988, as referred to in the existing tax credits regulations. With effect from 6 April 2005, these charges are now contained in the Income Tax (Trading & Other Income) Act 2005.

The Tax Credits (Definition & Calculation of Income) Regulations 2002 also need to take account of the forthcoming abolition of the exemption from National Insurance Contributions of Gurkhas serving in the British Army, currently in Schedule 1 to the Social Security (Categorisation of Earners) Regulations 1978 (S.I. 1978 No. 1689) and future changes in the arrangements for collecting income tax in respect of Gurkhas’ earnings. These amendments also disregard for tax credit purposes the Return to Work Credit in certain pilot areas in Northern Ireland, introduced in October 2005 under section 1 of the Employment & Training Act (Northern Ireland) 1950. The inclusion of the social security pension lump sum in the definition of “pension income” arises from Chapter 1 of Part 2 of the Finance (No. 2) Act 2005. The definition of “student income” is updated by reference to the Education (Student Support) Regulations 2005 and 2006 (S.I.

2005 No. 52 and S.I. 2006 No. 119) and the Assembly Learning Grants & Loans (Higher Education) (Wales) Regulations 2006 (S.I. 2006 No. 126 (W. 19)). The definition of “notional income” is extended by reference to the income tax charge on benefits received by the former owners of property referred to as pre-owned assets which took effect from 6 April 2005 by virtue of section 84 of, and Schedule 15 to, the Finance Act 2004.

The amendments to the Working Tax Credit (Entitlement & Maximum Rate) Regulations 2002 update references to the Employment Zones Regulations made under section 60 of the Welfare Reform & Pensions Act 1999 by reference to the most recent such provisions, namely the Employment Zones Regulations 2003 (S.I. 2003 No. 2438) and the Employment Zones Regulations (Allocation to Contractors) Pilot Regulations 2005 (S.I. 2005 No. 1125). These amendments also add child care agencies as defined in section 2 of the Regulation of Care (Scotland) Act 2001 and child care providers approved in accordance with the Tax Credits (Approval of Home Child Care Providers) Scheme (Northern Ireland) 2006 to the list of eligible care for the purposes of entitlement to the child care element of the working tax credit, set out in regulation 14 of the Working Tax Credit (Entitlement & Maximum Rate) Regulations 2002.

5. Extent

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

These regulations are subject to annulment and do not amend primary legislation. Accordingly, a certificate that the instrument is compatible with the Convention rights is not required.

7. Policy Background

The Pre-Budget Report announced a package of measures to ensure the tax credits system strikes the right balance between providing a stable award and maintaining the ability to respond to changes. One of these measures was to move the date for returning annual renewal forms from the end of September to the end of August.

When claiming the child and working tax credits, claimants are required to be present, ordinarily resident and, in respect of the child tax credit, also have a right to reside in the UK. Because regulation 3 (4) of the Tax Credits (Residence) Regulations 2003 treats workers and their families with rights of residence under EC law as ordinarily resident in the UK when claiming the working tax credit, any relevant changes in EC law should be reflected in that tax credits provision. In addition, it has been decided that the right to reside condition introduced for the purposes of claims to the child tax credit in the Tax Credits (Residence) (Amendment) Regulations 2004 should be made permanent.

When claiming the child and working tax credits, claimants are generally required to report income of a full tax year which is chargeable to income tax. This reflects that fact that the child and working tax credits are part of the tax system. Because the Tax Credits (Definition & Calculation of Income) Regulations 2002 refer to tax law definitions of various types of income, any relevant changes in tax law should be reflected in the tax credits definition of “income”.

The child care element of the working tax credit can only be claimed by a claimant who uses eligible child care as defined in regulation 14 of the Working Tax Credit (Entitlement & Maximum Rate) Regulations 2002. The Northern Ireland Child Care Approval Scheme is to be introduced from 6 April 2006, to mirror a scheme introduced in England in April 2005 by the Department for Education & Skills (DfES). This means that the list of eligible child care for the purposes of claiming the child care element of the working tax credit needs to be amended to refer to the new scheme in Northern Ireland. In addition, the scope of eligible child care in Scotland for tax credit purposes is being clarified to confirm that it extends to care provided by child care agencies.

Regulation 1 provides that these Regulations shall come into force on 6 April 2006.

Regulation 2 amends regulations 11 (3) (a) and 33 (a) of the Tax Credits (Claims & Notifications) Regulations 2002 to bring forward the deadline for returning annual renewal forms from 30 September to 31 August. This is in line with the announcement in the Pre-Budget Report of 5 December 2005 and will mean that by 31 August 2006, tax credit awards for 2005-06 will be finalised and initial claims for 2006-07 will be treated as made.

Regulation 3 amends regulation 5 (2) of the Child Tax Credit Regulations 2002 to delete the existing reference to "the date of leaving education" and to insert "the relevant leaving date", in line with other changes made to those Regulations by the Child Tax Credit (Amendment) Regulations 2006.

Regulation 4 updates regulation 3 (4) of the Tax Credits (Residence) Regulations 2003 to reflect that Council Directive 2004/38/EC has amended Council Regulation (EEC) No. 1612/68 and has repealed Council Directives No. 68/360/EEC and No. 73/148/EEC.

Regulation 5 removes the date limit contained in regulation 1 (2) of the Tax Credits (Residence) (Amendment) Regulations 2004, to ensure that the right to reside condition in respect of the child tax credit in regulation 3 (5) of the Tax Credits (Residence) Regulations 2003 shall not lapse on 1 May 2006.

Regulation 6 introduces the amendments to the Tax Credits (Definition & Calculation of Income) Regulations.

Regulation 7 updates regulation 2 (Interpretation) of those Regulations. It:

- inserts a reference to the Commissioners for HM Revenue & Customs in place of the Commissioners of Inland Revenue;
- updates the definition of "employment zone" by reference to the current Employment Zones Regulations;
- inserts a reference to the Income Tax (Trading & Other Income) Act 2005; and
- deletes the reference to Schedule D of the Income & Corporation Taxes Act 1988.

Regulation 8 amends regulation 3 (Calculation of income of claimant) of the Tax Credits (Definition & Calculation of Income) Regulations. It:

- makes explicit that a trading loss is not available for tax credits relief unless the trade is carried out on a commercial basis and with a view to the realisation of a profit;
- updates the provision dealing with unremittable foreign income by reference to Chapter 4 of Part 8 of the Income Tax (Trading & Other Income) Act 2005; and
- updates references to a “UK property business” and an “overseas property business” by reference to the Income Tax (Trading & Other Income) Act 2005.

Regulation 9 amends regulation 4 (Employment income) of the Tax Credits (Definition & Calculation of Income) Regulations. It deletes the deeming provision in respect of Gurkhas’ earnings in paragraphs (2A) and (2B) which currently treats Gurkhas as receiving gross earnings on the same basis as British soldiers of the equivalent rank and seniority. It also inserts in Table 1 in paragraph (4) a disregard of payments made to participants in the “Return to Work Credit” pilots in Northern Ireland.

Regulation 10 amends regulation 5 (Pension income) of the Tax Credits (Definition & Calculation of Income) Regulations by extending the definition of “pension income” in paragraph (1) to include trivial commutation and winding lump sum payments and death benefits and the social security pension lump sum.

Regulation 11 amends regulation 6 (Trading income) of the Tax Credits (Definition & Calculation of Income) Regulations by reference to the rewritten provisions in Part 2 of the Income Tax (Trading & Other Income) Act 2005.

Regulation 12 amends regulation 8 (Student income) of the Tax Credits (Definition & Calculation of Income) Regulations by reference to the Education (Student Support) Regulations 2005 and 2006 and the Assembly Learning Grants & Loans (Higher Education) (Wales) Regulations 2006.

Regulation 13 amends regulation 9 (Payments of income in connection with students to be disregarded for the purposes of regulation 3) of the Tax Credits (Definition & Calculation of Income) Regulations by reference to the rewritten provisions in the Income Tax (Trading & Other Income) Act 2005.

Regulation 14 amends regulation 10 (Investment income) of the Tax Credits (Definition & Calculation of Income) Regulations. It updates the reference to chargeable event gains on life insurance policies in paragraph (1) (e) and the disregards in paragraph (2) and Table 4 in regulation 10 by reference to the rewritten provisions in the Income Tax (Trading & Other Income) Act 2005. It also inserts a new item in Table 4 to disregard for tax credit purposes payments made under immediate needs annuities and health and employment insurance policies which are exempt from tax by virtue of sections 725 and 735 respectively of that Act.

Regulation 15 amends regulation 11 (Property income) of the Tax Credits (Definition & Calculation of Income) Regulations by reference to the rewritten provisions in Part 3 and, as regards the “rent-a-room” scheme, Chapter 1 of Part 7 of the Income Tax (Trading & Other Income) Act 2005.

Regulation 16 amends regulation 12 (Foreign income) of the Tax Credits (Definition & Calculation of Income) Regulations by reference to the rewritten provisions in the Income Tax (Trading & Other Income) Act 2005.

Regulation 17 amends regulation 14 (Claimants treated for any purposes as having income by virtue of the Income Tax Acts) of the Tax Credits (Definition & Calculation of Income) Regulations. It updates certain existing references to the Income & Corporation Taxes Act 1988 by reference to the rewritten provisions in the Income Tax (Trading & Other Income) Act 2005. It also extends the scope of regulation 14 by including the income tax charge on previously owned assets introduced by section 84 of, and Schedule 15 to, the Finance Act 2004.

Regulation 18 amends regulation 18 (Miscellaneous income) of the Tax Credits (Definition & Calculation of Income) Regulations by deleting the current reference to Case VI of Schedule D and replacing it with a reference to Part 5 of the Income Tax (Trading & Other Income) Act 2005.

Regulation 19 amends certain provisions in Tables 6 and 8 in regulation 19 (General disregards in the calculation of income) of the Tax Credits (Definition & Calculation of Income) Regulations. It deletes the former legislative references to the tax reliefs for foster carers and adopters and the “rent-a-room” scheme as it applies to adult respite carers and replaces them by reference to the equivalent provisions in the Income Tax (Trading & Other Income) Act 2005.

Regulation 20 (2) and (3) replaces the reference to the Employment Zones Regulations 2000 in regulations 2 (1) and 4 (2) (f) of the Working Tax Credit (Entitlement & Maximum Rate) Regulations 2002 with references to the Employment Zones Regulations 2003 and the Employment Zones (Allocation to Contractors) Pilot Regulations 2005.

Regulation 20 (4), (5) and (6) adds child care agencies as defined in section 2 of the Regulation of Care (Scotland) Act 2001 and child care providers approved in accordance with the new Tax Credits (Approval of Home Child Care Providers) Scheme (Northern Ireland) 2006 to the list of eligible child care in regulation 14 of the Working Tax Credit (Entitlement & Maximum Rate) Regulations.

8. Impact

A Regulatory Impact Assessment has not been prepared for this instrument because it has no impact on business, charities or the voluntary sector.

The estimated yield of bringing forward the deadline for annual renewal forms is included in the estimate of the Pre-Budget Report tax credits package.

The changes to the Child Tax Credit Regulations, the Tax Credits (Residence) and (Residence) (Amendment) Regulations, the Tax Credits (Definition & Calculation of Income) Regulations and the Working Tax Credit (Entitlement & Maximum Rate) Regulations will have negligible impact on the Exchequer.

9. Contact

The lead official is:

David Woodhouse
HM Revenue & Customs
Benefits & Credits Group
100 Parliament Street
London
SW1A 2BQ
Tel: 020-7147-2477
E-mail: David.Woodhouse@hmrc.gsi.gov.uk